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In the Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES OF AMERICA, PETITIONER

v.

GRANITE CONSTRUCTION COMPANY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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Respondent's submission confirms the importance of the question presented here. Respondent concedes that the Federal Circuit's adoption of an "economic waste" exception to the strict compliance doctrine is unprecedented in that court. Br. in Opp. 10. Respondent also acknowledges that the Federal Circuit is the "single forum" in which the issue is likely to arise. *Id.* at 7. Most importantly, based on the view that government contract specifications "generally * * * overstate the government's actual minimum needs" (*id.* at 23), respondent defends the "economic waste" exception as a means by which courts can decide whether work that does not meet contract specifications "in fact meets the government's minimum needs" (*id.* at 17). Yet it is the very willingness of the Federal Circuit to second-guess the technical specifications for a federal lock and dam

project—and to invite similar requests for retrospective judicial revision of contract specifications—that represents a drastic and disturbing change in the law warranting review by this Court.

1. A standard clause, included in virtually every government construction contract for the last 30 years, provides that when work does not meet contract specifications, the contractor "shall, without charge," correct that work. See Pet. 10-11 & n.8. That clause reflects the common law principle that the government has the right to insist on strict compliance with the requirements of its contracts. See, *e.g.*, *Farwell Co.* v. *United States*, 148 F. Supp. 947, 949 (Ct. Cl. 1957). The strict compliance doctrine has deep roots in case law and regulations, and is a "fundamental rule" of government procurement law. J. Cibinic & R. Nash, *Administration of Government Contracts* 571 (2d ed. 1985).

By contrast, there is virtually no legal support for an "economic waste" exception to the strict compliance rule. Respondent confirms our observation (Pet. 14-15 n.11) that only two decisions by agency boards of contract appeals have applied such an exception to award compensation to a contractor for correcting nonconforming work. See Br. in Opp. 11 & n.6. Moreover, respondent does not dispute our observation (Pet. 15 n.11) that other board decisions have applied the strict compliance rule to require correction of defective work at significant cost without discussing economic waste. See J. Cibinic & R. Nash, *supra*, at 574-575.

Aside from the two agency decisions, respondent relies solely on *H.L.C. & Associates Constr. Co.* v. *United States*, 367 F.2d 586 (Ct. Cl. 1966). See Br. in Opp. 10, 15, 19, 24. *H.L.C.* cannot, however, "fairly be read" as "endors[ing]" an "economic waste" exception, as respondent

asserts (Br. in Opp. 11).[1] On the contrary, in *H.L.C.* the Court of Claims declined to adopt an economic waste exception to the strict compliance rule.

The contractor in *H.L.C.* sought additional compensation for replacing defective wiring on a government construction project. 367 F.2d at 587. The contractor argued, first, that the government "constructive[ly] change[d]" the contract by requiring "that the wiring be installed as specified by the contract"; and, second, "that the substitution of [conforming wiring] was a useless and unnecessary change * * * and consequently the contracting officer should have accepted the original installation as having met the test of substantial performance." *Id.* at 599 (internal quotation marks omitted).

The Court of Claims rejected both arguments based on the strict compliance rule. With respect to the contractor's constructive-change argument, the court held:

> It was not within [the contractor's] province to decide what materials were equally satisfactory and substitute his judgment for that of the Government. The Government had a right to insist on use of the wiring specified, regardless of its reasons for selection of the [specifications].

H.L.C., 367 F.2d at 598. The court similarly based its rejection of the contractor's substantial-performance argument on "the right of the Government to expect that [the wiring], which the specifications called for would be used regardless of its reasons for so specifying." *Id.* at 599. Thus, far from "endors[ing]" an economic waste

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[1] In contrast to respondent, the Federal Circuit did not read *H.L.C.* as supporting an "economic waste" exception. Instead, the Federal Circuit described *H.L.C.* as a decision that merely "discussed the economic waste doctrine but determined that the case did not support a finding of economic waste." Pet. App. 21a.

exception (Br. in Opp. 11), the court in *H.L.C.* held that such an exception did not qualify the government's right to insist upon strict compliance.[2]

2. As we explain in our petition (at 10-12), the Federal Circuit derived its "economic waste" exception from the public interest provision in clause GP-10 of the contract. The clause provides in relevant part:

> The contractor shall, without charge, replace any material or correct any workmanship found by the Government not to conform to the contract requirements, unless in the public interest the Government consents to accept such material or workmanship with an appropriate adjustment in contract price. * * *

Pet. App. 29a. The court concluded, in effect, that the public interest provision imports the principle of economic waste developed in case law concerning private contract disputes. *Id.* at 15a-22a. Respondent makes a similar contention. Br. in Opp. 14.

Both the court and respondent ignore the language of clause GP-10. The clause requires the contractor "without charge" to correct "any" nonconforming work; it thus gives the government the right to insist upon strict compliance with contract requirements. The public interest proviso does not qualify that right; it does not say that the government "shall" or "must" accept nonconforming work if it is in the public interest to do

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[2] The *H.L.C.* court's subsequent discussion of "economic waste" was clearly dictum. The court addressed economic waste only after "grant[ing], for the sake of discussion, that the [nonconforming wiring] * * * served the purpose" for which it was intended. *H.L.C.*, 367 F.2d at 599-600. Moreover, the court determined that "the application of the test of substantial performance to the instant case * * * is still by no means clear." *Id.* at 600.

so. It merely gives the government the discretion to "consent[]" to accept nonconforming work. Rather than restricting the government's right to reject nonconforming work, the public interest provision gives the government an additional right: *i.e.*, the right to accept nonconforming work in the public interest.

Clause GP-10 clearly and comprehensively addresses the government's remedy in the present situation. The government had an unqualified right to reject the defective waterstop; it also had the right to accept the waterstop with an appropriate adjustment in the contract price. Because this clause and its modern version are required by regulations that, as respondent admits, "have the force and effect of law" (Br. in Opp. 18 (internal quotation marks omitted)), and because those clauses do not restrict the government's right to insist on strict compliance, the Federal Circuit could not rely on federal common law to impose such a restriction. See *City of Milwaukee* v. *Illinois*, 451 U.S. 304, 314 (1981).

Moreover, as we explain in our petition (at 17), neither clause GP-10 nor any other source of law provides a meaningful standard for judicial review of the government's decision to reject nonconforming work. For that reason, the government's decision to reject nonconforming work under clause GP-10 is committed to agency discretion by law. See, *e.g.*, *Heckler* v. *Chaney*, 470 U.S. 821, 830 (1985).

That is not to say that the government's conduct under clause GP-10 is immune from judicial review. The Federal Circuit may, for example, review the government's finding that work does not conform to contract specifications. See Pet. 5 n.5. But the Federal Circuit in this case did not find that the waterstop conformed to contract specifications. Instead, the court concluded that

the government's specifications reflected an unnecessarily high margin of safety. See Pet. App. 17a.

The question of whether work meets contract specifications is quite different from the question of whether those specifications reflect too high a margin of safety. The Federal Circuit has neither the authority nor the expertise to second-guess the government's design of technical specifications for a federal waterway project. And prior to this case, neither the Federal Circuit nor its predecessor has ever presumed to do so. On the contrary, the Court of Claims in *H.L.C.* expressly found that the government's specifications for electrical wiring were "over-designed." 367 F.2d at 595. Yet it upheld the government's "right to insist on use of the wiring specified, regardless of its reasons for selection of the [specifications]." *Id.* at 598. The Federal Circuit's contrary holding warrants this Court's review.

3. As we explain in our petition (at 18-21), the strict compliance rule serves three important purposes in the procurement process: (1) It preserves the integrity of the bidding process by discouraging contractors from submitting bids based on nonconforming workmanship or material, see J. Cibinic & R. Nash, *supra*, at 571; (2) it avoids litigation by clearly prescribing the consequences of a contractor's failure to meet contract specifications; and (3) it enables the government to develop uniform specifications for frequently used material by preventing contractors from arguing about whether the specifications for a specific project are unnecessarily stringent. Respondent's contentions that these purposes will not be undermined by the Federal Circuit's creation of an "economic waste" exception are unpersuasive.

Respondent first argues that the procurement process will be unaffected because the Federal Circuit's decision

merely reiterates a principle articulated by the Court of Claims in *H.L.C.* Br. in Opp. 19, 22, 24. As we have explained, however, the decision here is at odds with *H.L.C.*

Respondent next asserts that the Federal Circuit's "economic waste" exception will apply only in "rare and extreme circumstances." Br. in Opp. 19. The Federal Circuit's analysis belies that assertion. In concluding that the government committed "economic waste," the Federal Circuit relied solely on respondent's expert, who testified that, although the waterstop did not conform to contract specifications, it provided an adequate margin of safety. Pet. App. 16a-18a. Testimony of that sort is easy to come by. As we explain in our petition (at 3 n.2, 20-21), the Corps has developed uniform specifications for waterstop and many other materials widely used on construction projects. The inevitable result of uniform specifications is that in some cases they will be more stringent than they might have been if they had been designed for each project. Consequently, a contractor will often be able to argue that some of the specifications for a project reflect an unnecessarily high margin of safety. The Federal Circuit's decision gives contractors a significant incentive to make such arguments.[3]

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[3] The facts of this case also belie respondent's contention that the issue of "economic waste" will arise only in exceptional cases. Respondent's suggestion that this is an exceptional case is based on an inaccurate and incomplete description of the record. For example, respondent asserts that it installed the defective waterstop by mistake, and that the defect was discovered only after 10% had been installed because the government failed to test the waterstop adequately prior to installation. Br. in Opp. 1, 3, 5-6; see also *id.* at 22. Both courts below and the Board of Contract Appeals found, however, that after the government tested and approved an initial sample of waterstop, it reasonably relied on respondent's repeated

Respondent deprecates the value of uniform contract specifications, asserting that they "generally * * * overstate the government's actual minimum needs." Br. in Opp. 23. Contract specifications, however, by definition "state * * * the Government's actual minimum needs." 48 C.F.R. 10.001. The government has a strong interest in preserving its right to determine its needs and in paying only for work that meets them. That right will be seriously eroded if the decision below stands.

4. Even if we assume that courts could properly impose an economic waste exception, further review is warranted here because the Federal Circuit's analysis is fundamentally flawed.

Most importantly, the Federal Circuit erroneously assumed that economic waste principles suitable for

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representations that all of the waterstop used on the project came from the same batch as the sample initially approved. Pet. App. 12a-13a, 43a, 88a. Respondent also suggests that, when the defect was discovered, the Corps of Engineers unreasonably refused to provide respondent with design criteria for the waterstop. Br. in Opp. 4, 23 n.18. The Corps could not supply any criteria because there were no criteria for determining whether the waterstop was adequate for the Aberdeen project. That is because waterstop is an "off the shelf" item the specifications for which permit it to be used at all waterway projects. Pet. App. 63a-64a; C.A. App. 87, 101, 117. Significantly, respondent did not supply any data on the adequacy of its waterstop until the hearing before the Board of Contract Appeals, when it produced the report of a "waterstop expert." That report, on which the Federal Circuit relied heavily (Pet. App. 16a-18a), was not available to the contracting officer at the time he had to decide whether to require replacement of the waterstop. At that point, the officer had only the test results showing that the waterstop failed to meet virtually all of the contract specifications. See Pet. 3-4 & n.3. In sum, this case does not involve a contracting officer's obstinate and unprincipled rejection of material that fell just short of contract requirements, as respondent suggests. See Br. in Opp. 1-2, 7-8.

private contract disputes should be applied to government contract disputes without modification. As a result, the court failed to consider aspects of the government procurement process that have substantial economic importance. For example, the government's use of uniform contract specifications obviates the expenditure of costs and agency resources required to develop specifications on a project-by-project basis. The use of uniform specifications also enables producers of materials to realize economies of scale that result in lower prices. In addition, materials for which uniform specifications exist are usually easier to obtain on short notice than are materials designed for individual projects. Thus, adherence to uniform specifications provides significant economic benefits that the Federal Circuit ignored. [4]

The Federal Circuit's analysis is deficient in other ways as well. Although the court accepted respondent's assertion that the cost of replacing the defective waterstop was "extraordinarily high," Pet. App. 15a, the court did not make even an approximate determination of that cost, *id.* at 21a-22a. Nor did the court consider whether the defective waterstop could be replaced if it failed after the lock and dam began operation—and, if so, at what cost. Nonetheless, there was evidence suggesting that later replacement would not be possible. See *id.* at 89a-90a. Finally, the court did not consider whether

[4] The Federal Circuit also erred in assuming (Pet. App. 20a-21a) that the case law establishes a uniform approach to determining "economic waste." Compare Restatement (First) of Contracts § 346, at 572-573 (1932) with Restatement (Second) of Contracts § 348(2) (1982). See generally D. Dobbs, *Remedies* § 12.21, at 897 (1973); Farnsworth, *Legal Remedies for Breach of Contract*, 70 Colum. L. Rev. 1145, 1173-1174 (1970); Chomsky, *Of Spoil Pits and Swimming Pools: Reconsidering the Measure of Damages for Construction Contracts*, 75 Minn. L. Rev. 1445, 1450-1460 (1991).

defective waterstop would reduce the useful life of the project or increase the risk to public safety. Because the Federal Circuit did not consider these factors, it could not accurately assess the economic costs and benefits of the government's decision to have the nonconforming waterstop replaced.

5. The Federal Circuit's decision threatens enormous, adverse fiscal consequences for the federal government. As we explain in our petition, the government awards construction contracts worth billions of dollars each year. Pet. 21-23.[5] In accordance with the Federal Acquisition Regulation, virtually all of those contracts contain language similar to that on which the Federal Circuit relied in adopting an economic waste exception to the strict compliance rule. Pet. 10-11. Because the Federal Circuit is, as respondent notes (Br. in Opp. 7), the "single forum" among the courts of appeals for deciding government contract disputes, and because that court has incorrectly decided an issue of great legal and practical importance, review by this Court is warranted.

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[5] Respondent correctly notes (Br. in Opp. 22 n.17) an inadvertent error in our petition (at 22 n.16) regarding the value of construction contracts awarded by the Department of Transportation (DOT). We have confirmed with the DOT Contract Information Service that in fiscal year 1992, the DOT awarded construction contracts totalling $205 million; DOT's five-year total for fiscal years 1988 through 1992 is $1.85 billion. Respondent also points out that federal funds in the form of grants for construction are not governed by the FAR. Br. in Opp. 22 n.17. The dollar figures set forth above, however, do not include such grants; those figures reflect contracts with the government that are, with few exceptions, governed by the FAR.

For the foregoing reasons and those stated in the petition, certiorari should be granted.

Respectfully submitted.

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Solicitor General

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